



*As I see it*

## RECENTLY IT HAS BEEN CHEAPER TO OWN THAN TO RENT

**W**HEN I first became interested in real estate a good many years ago, there was a perennial discussion going on as to whether it was cheaper to own your own home or to rent. The argument was carried on year after year with considerable noise and fury, but with relatively few facts available. Actually, for the period in which I first heard the argument, a review of the figures would show that at that time it was far cheaper to rent than it was to own. This, however, has not been the case since the bottom of the depression of the 1930's.

In order to see what the actual experience has been, I have taken as an example, the sale of a single-family residence which sold last month in a suburb of St. Louis, and which was purchased by Mr. and Mrs. X in June 1943.

In order to make the figures more representative, I have assumed a purchase price for this property in June 1943 slightly different from the actual price at which the property was purchased. This was done, in order to make the increase in price from 1943 to the present, identical with the average increase on all residential properties, as shown by the index which we publish every month in the Trends Bulletin.

The actual sale last month of this single-family residence was made for \$24,500.00. According to our index, this property should have been bought in June 1943 for \$10,000.00. I have assumed that Mr. and Mrs. X spent \$2,000.00 on improving the property, other than on maintenance and repairs, making their cost from the capital gains tax angle \$12,000.00. Upon this basis, then, capital gain amounted to \$12,500.00. Theoretically, 13 years of additional depreciation on this property, during the period in which it was owned by Mr. and Mrs. X, should have reduced its value by from a quarter to a third, but actually its selling price increased, in spite of depreciation, by 125%.

It is necessary to make a few other assumptions, as these would affect the actual cost to Mr. and Mrs. X over the 13-year period. I am assuming that the joint income was \$12,500.00. Under this assumption, the tax on the capital gain of \$12,500.00 would be \$1,909.00.

Missouri has a State income tax with a capital gains tax, which, in this particular case, would amount to \$250.00. Deducting the Federal and State tax from the capital gain, leaves a gain, after taxes of \$10,341.00.

Had Mr. and Mrs. X put their \$10,000.00 plus the \$2,000.00 we have assumed that they used on capital improvements in a savings and loan association at 3% in June 1943, and had they compounded their interest every 6 months, the compound interest in 13 years would have amounted to \$5,672.40. The tax on this additional income would be \$1,818.75, resulting in a net increase in their income after taxes of \$3,803.65.

Over the 13-year period the real estate taxes on a property of this type, in this community, would average around \$400.00 a year, or, in other words, in the 13-year period, the taxes would have amounted to \$5,200.00. However, taxes are also deductible, and had our owners not owned this property, their taxable income would have been \$400.00 a year more than it actually was, and so their net income after taxes was reduced, not by \$5,200.00, but by \$3,464.64.

Recapitulating the cost to Mr. and Mrs. X of owning this property for the 13 years from 1943 to 1956, we have listed in the table below the significant factors:

Net capital gain after Federal and State income taxes . . . . .	\$10,341.00	
Cost to the owners in interest not secured on \$12,000.00, adjusted for taxes . . . . .	\$3,803.65	
Estimated real estate taxes for 13 years, adjusted for income taxes . . . . .	3,464.64	7,268.29
Net profit after taxes for 13-year period . . . . .		\$ 3,072.71
Net profit per year . . . . .	\$ 236.36	
Net profit per month . . . . .	19.70	

This very favorable showing is due largely to the inflationary trends we have experienced since 1943, and to the fact that taxes and capital gains are given considerable weight in determining the net tax liability to the Federal Government. However, June 1943, the period in which we assume this property was purchased, was not selected to give the most favorable results, as many periods from 1933 to the present would have yielded results more favorable than those we have used.

No cognizance has been taken in this study of maintenance costs, as it is assumed that the owners would have had many of these costs had they rented a single-family residence, and their rent would not be a tax deductible item.

In order to paint the worst possible case for home ownership I have assumed that Mr. and Mrs. X purchased a home in June 1925 and that they sold it in June 1932, shortly after the bank collapse. In order to make this case as comparable as possible with the later purchase by Mr. and Mrs. X, I have assumed about

the same quality of house which they purchased later. This house in 1925 would have sold for \$14,400.00. I am assuming that the purchasers spent, in addition, \$600.00 on capital improvements, making their total investment \$15,000.00. I am estimating the taxes at \$200.00 a year. If this property underwent the normal experience of properties at that time, it would have sold in June 1932 for \$7,000.00, or \$8,000.00 less than its cost 7 years earlier. In order to arrive at a monthly cost, I have started with the assumption that an alternate investment for the \$15,000.00 would have been a first mortgage paying 6% interest. At that time, individuals considered real estate mortgages excellent investments, and most of these mortgages were paying 6% interest. Six percent interest on \$15,000.00 is \$900.00 a year. I am also assuming that Mr. and Mrs. X had an income of \$6,000.00 a year, which means that their total income taxes on the \$6,300.00 worth of interest would amount to \$124.50 at the tax rates which were then in existence. In other words, after taxes, the \$6,300.00 would yield \$6,175.50. Since they invested in the house in place of a mortgage, their net income after taxes would have been reduced by \$6,175.50.

Their real estate taxes on this property would probably total \$1,400.00 for the 7 years. These taxes would be deductible on their income tax, but this deduction would reduce their tax by only \$28 over the 7-year period, leaving us a net cost for taxes of \$1,372.00.

In 1932, it was possible to take a loss on the sale of a capital asset. One-eighth of the loss could be deducted from any amount paid in taxes. One-eighth of the \$8,000.00 loss would amount to \$1,000.00, but, since their total income tax in 1932 on a \$6,000.00 income amounted to only \$140.00, they could get only \$140.00 credit on their \$8,000.00 loss, which reduced their loss to \$7,860.00. Recapitulating their cost during the 7-year period gives us the following:

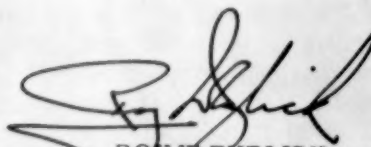
Net capital loss after income tax . . . . .	\$ 7,860.00
Loss in interest . . . . .	6,175.50
Loss in real estate taxes paid . . . . .	<u>1,372.00</u>
Total . . . . .	\$15,407.50

Since this was the cost in 7 years, the cost per year was \$2,201.00, or a monthly cost of approximately \$183.50.

The striking difference between these two sets of figures is due primarily to the fact that the one period was an inflationary period, the other period a deflationary period.

If these figures are to serve as any clue as to what the future might hold, it is necessary to accept, first, some hypothesis about inflation or deflation in the future. It seems to me that after some readjustment, which may prove mildly

deflationary, the general trend, during at least the next generation, will be inflationary in character, and, while there is the probability, barring wars, that the inflations will not be so great as they have been in the past 20 years, they will still be of sufficient strength to offset depreciation with a relatively small monthly cost for home ownership.



ROY WENZLICK